exchange switch, alongside its voice mail platform in Rochester "in an attempt to charge reciprocal compensation for incoming traffic and to obtain the lion's share of access revenues for incoming toll calls."[41] Frontier disputes the premise that society benefits from CLECs reducing rates to ISPs, contending that any such benefit is simply a poorly thought through, unnecessary, and anti-competitive subsidy.

Relief from this situation is warranted, Frontier continues, because reciprocal compensation makes sense only where, in its absence, the originating LEC would receive compensation for the call and the terminating LEC would not, and where the costs borne by both LECs are nearly equal. Internet traffic, it argues, does not meet these conditions, inasmuch as most of it originates from flat rate residential subscribers who pay no additional charges for their calls to ISPs. Meanwhile, even in the absence of reciprocal compensation, the CLEC receives incremental revenues from its ISP customer, while the ILEC is required not only to pay reciprocal compensation but to incur substantial expenses for the Internet traffic it carries.[42] (CPB responds that these costs, attributable to the demands imposed by Frontier's own customers, are irrelevant to the proper level of reciprocal compensation.)

Bell Atlantic-New York presents similar arguments. It cites statements, drawn from CLEC web sites and submitted in Bell Atlantic-New York's comments in the Chatline Proceeding, to the effect that many CLECs seek customers with convergent traffic "simply for the purpose of collecting

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[41] Frontier's Initial Brief, p. 4, n. 11.

[42] Frontier observes that the party actually responsible for the costs is the ISP, which charges its end users for its services and, in some situations, receives from the CLEC a portion of the reciprocal compensation revenues received by the CLEC on its account. Frontier suggests that ISPs should, in fact, be regarded as carriers who, rather than receiving compensation from ILECs, should be obligated to pay carrier access charges.

intercarrier compensation payments from incumbent LECs. Indeed, in many cases intercarrier compensation has become the principal line of business for such carriers."[43] Noting that during the first quarter of 1999, the aggregate measured traffic flow from Bell Atlantic-New York to CLECs was more than ten times greater than the flow in the reverse direction,[44] Bell Atlantic-New York contends that the market is being shaped by regulation, that ILECs are being forced to finance their competitors, and that customers are injured because CLECs are discouraged from becoming the kind of full service providers who will bring the benefits of true competition.

Bell Atlantic-New York goes on to describe the FCC's symmetry and functional equivalence principles for reciprocal compensation, and it argues that though the FCC ISP Ruling permits states to apply those requirements to ISP traffic, it does not require them to. It points as well to the Framework Order and urges us to reaffirm and apply the Framework Order's principles of universal service (which Bell Atlantic-New York sees as favoring "intercarrier compensation rules that provided incentives for provision of a broad range of services to a wide variety of customers"[45]); symmetry (meaning that the ILEC's rate levels should apply to the CLEC as well, the question being which rate applies under which circumstances); functional equivalence, defined as "the ability to terminate calls to all customers served by a carrier's unique, stand alone network by delivery to a single point of interconnection[46]"); and efficient interconnection (requiring, as a further condition of charging tandem rates, that CLECs "provide the incumbent appropriate interconnection options

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[43] Bell Atlantic-New York's Initial Brief, p. 1.

[44] Tr. 96, 165-166.

[45] Bell Atlantic-New York's Initial Brief, p. 15.

[46] Framework Order, p. 6, n. 1, cited at Bell Atlantic-New York's Initial Brief, p. 16, n. 40.

within their network that would allow the incumbent access to more efficient connections"[47]). Bell Atlantic-New York adds that the symmetry principle, as we and the FCC have adopted it, makes actual CLEC costs irrelevant.

As discussed in more detail in connection with its specific proposals, Bell Atlantic-New York maintains that the termination of convergent traffic enjoys efficiencies that are unavailable when more broadly dispersed traffic is terminated. The CLECs respond that these claims are unsubstantiated.

The CLECs' Positions

Although the CLECs' briefs vary in their treatment of the issues, several common themes may be identified. This section is organized around those themes.

1. The Significance of Carrying Convergent Traffic

AT&T, among others, argues that traffic imbalances say nothing about the proper level of reciprocal compensation and that reciprocal compensation, in fact, contemplates traffic imbalances, without which the simpler bill-and-keep system could have been adopted. It contends as well that Bell Atlantic-New York overlooks other traffic imbalances that run in its favor, such as its termination of 2.7 times as many minutes of wireless traffic as CLECs terminate for it. Mid-Hudson/Northland and MCI, among others, note that it was the ILECs that, over the CLECs' objection, favored creation of the reciprocal compensation mechanism; these parties urge that the ILECs be required to accept the consequences of their tactics and not be bailed out now that their bet has gone sour.

Looking to the genesis of the traffic imbalance rather than its implications, several CLECs, such as CTSI et al., attribute the tendency of some CLECs to seek convergent traffic customers to Bell Atlantic-New York's continued

[47] Framework Order, p. 6, cited at Bell Atlantic-New York's Initial Brief, p. 16.

imposition of barriers to more broad-based market entry. CTSI et al. assert that

> If Bell Atlantic effectively denies access to loops, and it is cost-prohibitive for the entrant to deploy them, serving customers that require fewer loops is clearly rational business behavior. If Bell Atlantic provides woefully inadequate operations support systems that make large-scale ordering and provisioning completely unreliable, providing services that are less dependent on effective OSS interfaces is also logical. If Bell Atlantic neglects a market segment by failing to offer collocation arrangements that customers in that market segment want, providing those collocation arrangements is one way to compete. And if Bell Atlantic makes it extremely difficult to transition a customer from Bell Atlantic to a CLEC, targeting customers that are establishing businesses is also logical. In all of these cases, ISPs are excellent customers for CLECs.[48]

CPB responds that reciprocal compensation rates should be cost-based regardless of who pays whom.

Some CLECs broaden this point, asserting that pursuing niche markets is not merely a reaction to barriers erected by ILECs but is a proper strategy for entering the market, either enroute to becoming a full-service provider or as an inherently reasonable business plan in itself. Mid-Hudson/Northland, TRA, and others urge us to avoid making changes that would undermine the expectations of small, innovative carriers who had relied in good faith on the existing regulatory structure to provide them revenue streams from niche markets--and especially not to do so in order to protect ILEC monopolists from the consequences of their own mistakes in favoring reciprocal compensation. (Bell Atlantic-New York challenges the premise of reliance, asserting that CLECs recognized the possibility that the existing rules might

[48] CTSI et al.'s Initial Brief, pp. 10-11.

change; for that reason, among others, it sees no need for a transition period before new arrangements are introduced.)

Mid-Hudson/Northland add that the sharing by CLECs of revenues with ISP customers (which Bell Atlantic-New York cites as evidence that reciprocal compensation revenues that were improperly above cost) is nothing more than the sharing of cost savings with end user customers, in a manner conceptually the same as an ILEC's attracting a prospective customer with an individual case basis pricing arrangement substantially below the tariffed price. Since the beneficiaries of the practice are end users, Mid-Hudson/Northland suggest, the practice should be encouraged, not discouraged.[49]

Reinforcing the propriety of pursuing of niche markets, MCIW, the Cable Association, and others assert that Bell Atlantic-New York itself does so, citing its recent introduction of Internet Protocol Routing Service (IPRS) to attract ISP customers. The Cable Association notes that the service was introduced following our denial of Bell Atlantic-New York's request for immediate relief from reciprocal compensation obligations relating to ISP-bound traffic; and it suggests that granting the request, which the Cable Association characterizes as one for protection from competitive forces, would have vitiated Bell Atlantic-New York's incentive to introduce the new service. In response, Bell Atlantic-New York denies that IPRS was a reaction to our decision, arguing it could never have been planned and introduced that quickly. More broadly, it objects to the premise that it should be encouraged to compete to retain its customers by being required to subsidize its competitors.

In contrast to the CLECs who emphasize the propriety of pursuing niche markets, others point to the distinctions among CLECs, some of which are, or aspire to be, full service providers. They urge us to do nothing in this proceeding that

[49] Mid-Hudson/Northland's Initial Brief, p. 17.

would interfere with their ability to function in that capacity. Without suggesting that a focus on ISP or convergent traffic is inherently abusive, they argue that CLECs that may be found to be abusing the existing regulatory structure should be pursued separately, in a manner that does not protect the ILECs from competition by full service, facilities-based providers. CTSI et al., for example, cite testimony that they have not limited themselves to high volume convergent traffic customers, and they object to a one-size-fits-all approach.[50]

The point is emphasized by Time Warner and Lightpath. Lightpath contends that it serves a diverse customer base and points to the blended reciprocal compensation rate in its interconnection agreement with Bell Atlantic-New York, which permits it to receive reciprocal compensation based on end-office rates for traffic terminated via end-office trunks and on tandem rates for traffic terminated via tandem trunks.[51] It charges that Bell Atlantic-New York's effort to seek broad changes in existing reciprocal compensation arrangements rather than pursuing the few CLECs who allegedly abuse the system represents an effort to use the regulatory system to undermine competitive carriers in the one area where they have succeeded in eroding Bell Atlantic-New York's market share.[52] It asks us "to maintain the status quo--especially with respect to full-service, facilities-based carriers. . . ."[53]

Time Warner, meanwhile, urges recognition of the variation in CLECs' business plans and operating networks, asserting that "responsible CLECs, those that design their networks and their points of interconnection . . . based on

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[50] CTSI et al.'s Initial Brief, p. 21.

[51] Lightpath's Initial Brief, p. 16.

[52] Ibid., pp. 5-6. The Cable Association argues to similar effect. Cable Association's Initial Brief, p. 4.

[53] Lightpath's Reply Brief, p. 3.

sound engineering principles for the flow of both originating and terminating traffic, have built their networks to serve a broad range of local telephone customers."[54] It adds that "the ILECs have offered no evidence to dispute the fact that responsible CLECs have built out, and continue to augment, their networks as necessary to handle actual and anticipated two-way traffic volumes among providers."[55] Recognizing this degree of variation among CLECs, and attempting to provide incentives for CLECs to build out their networks, Time Warner offers its own proposed modification, described in detail below, to the existing reciprocal compensation scheme.

Bell Atlantic-New York responds that there is no basis for distinguishing among CLECs in this way and that its proposals are intended not to punish vice or reward virtue but only to reflect the fact that it costs less to deliver convergent traffic than to deliver traffic to numerous, widely dispersed customers. It therefore would apply its proposals to the convergent traffic carried by FSPs as well as to niche players.

[54] Time Warner's Initial Brief, p. 4, footnotes omitted.

[55] Ibid., p. 5.

2. Relationship between Traffic Ratios and Costs

Many CLECs assert that the ILECs have shown no relationship between the type of traffic carried and the costs incurred to terminate it; they insist that "a minute is a minute," regardless of the type of traffic being carried.[56] CompTel, for example, cites Bell Atlantic-New York's witness's confirmation that it uses the same network facilities for all types of traffic, and e-Spire/Intermedia note the witness's statement that network components are not related to traffic imbalances.[57] Bell Atlantic-New York disputes these characterizations of its witness's testimony, contending, among other things, that the use of similar facilities, referred to by the witness, does not mean the facilities are identical.[58]

MCIW similarly contends that Bell Atlantic-New York failed to show that CLECs' costs are lower than ILECs' because they provide service to convergent customers; it cites its own witness's statement that

> virtually all of the CLECs in this case provided information that, in aggregate, demonstrates that ISP traffic is being routed through the same interconnection, transport, and circuit switching equipment that all other traffic is being routed over. [Bell Atlantic-New York] provided similar testimony stating that, to the extent that it could identify ISPs separately from other end users, calls to those ISPs are also being routed through the same interconnection, transport, and switching equipment and facilities as any other type of end user call.[59]

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[56] TRA's Initial Brief, pp. 3-4.

[57] CompTel's Initial Brief, p. 4, citing Tr. 296, 307, 308; e-Spire/Intermedia's Initial Brief, pp. 6-7, citing Tr. 297-298.

[58] Bell Atlantic-New York's Reply Brief, p. 15, n. 30.

[59] Tr. 722, cited in MCIW's Initial Brief, p. 4.

CTSI et al. cite in particular what they characterize as Bell Atlantic-New York's testimony that the length of the loop has nothing to do with the carrier's terminating costs.[60] Lightpath, apparently distinguishing full-service CLECs from others, states that "despite extensive testimony filed by both incumbent and competitive carriers, no evidence has been presented to demonstrate that terminating large volumes of calls to single customers is more cost effective for full service, facilities-based providers than terminating other types of traffic."[61]

Several CLECs stress the centrality of the functional equivalence determination in deciding whether the rate should be set at the tandem or end-office level or at some point in between. AT&T notes our statement in the Framework Order that functional equivalence does not depend on a CLEC's network architecture as long as the CLEC can terminate calls to all customers served by its network through a single point of interconnection. Disputing Bell Atlantic-New York's suggestion that CLECs' use of a single-switch network architecture may provide them efficiencies and lower costs that would warrant withholding reciprocal compensation at tandem rates, AT&T explains that a CLEC must use the single-switch network architecture in the early stages of competition until it gains volumes that would warrant the installation of additional end- office and tandem switches.[62] CompTel notes the FCC's determination that a CLEC is entitled to a tandem rate in cases where its switch serves a geographic area comparable to that served by the ILECs tandem switch. MCIW see the functional equivalence doctrine as permitting a state commission to determine whether a particular CLEC is entitled to the tandem rate on the basis of "economically

[60] Tr. 178, cited in CTSI et al.'s Initial Brief, pp. 8-9.

[61] Lightpath's Initial Brief, p. 2.

[62] AT&T's Initial Brief, p. 8.

relevant considerations, mainly the geographic coverage that the CLEC's switch supports"[63] instead of on the basis of such irrelevant considerations as traffic ratios. Lightpath argues that its system meets both the FCC's geographic area standard and our single point of interconnection standard and that its consequent tandem functionality is not vitiated by the fact that it serves some convergent customers. It asserts that

> once a CLEC has made the necessary investment to build out a full facilities-based network that meets the commissions' [i.e., FCC's and PSC's] definitions of tandem functionality, it is entitled to be compensated for its costs using tandem switching as a proxy. . . Thus, a CLEC's right to receive tandem termination rates is based on the overall functionality of the switch with respect to calls and all customers served by the CLEC's switch, and not on the characteristics of a particular call or type of traffic.[64]

In response, CPB maintains that tandem functionality is not needed to terminate calls to a small number of large-volume customers and that such customers can be served using high-capacity facilities having a lower cost-per-minute than the low-capacity facilities used to serve a large number of widely dispersed customers. It urges us to reflect these cost differences in the reciprocal compensation rates applicable to traffic terminated to large-volume customers. Frontier asserts that these differences mean that a lower compensation rate for this type of traffic would be consistent with the federal requirements, and it points to Time Warner's recognition of cost differences between convergent and other traffic.

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[63] MCIW's Initial Brief, p. 5.

[64] Lightpath's Initial Brief, pp. 14-15 (emphasis in original).

3. Other Cost-Related Issues

Several CLECs argue that the cost calculus should recognize the fact ILECs avoid costs when CLECs terminate traffic that they originate. AT&T states, for example, that

> [Bell Atlantic-New York's] own TELRIC costs form the basis for the existing rates. If [Bell Atlantic-New York] terminates less in- bound ISP traffic because such traffic is terminated instead by CLECs, [Bell Atlantic-New York] saved the costs of delivering such traffic. As long as such costs are appropriately calculated, [Bell Atlantic-New York] suffers no loss and cannot complain that an "imbalance" in traffic or payments represents a basis for altering rates.[65]

TRA adds that the ILEC's retail rates recover termination costs and that allowing an ILEC to avoid responsibility for those costs, by delivering traffic to a CLEC for termination without paying full compensation, would unjustly enrich the ILEC and represent "a classic monopoly abuse of the ILEC's customers."[66]

Some CLEC's respond to Bell Atlantic-New York's concern that its reciprocal compensation payments exceed the revenues it receives from end-users that place calls to ISPs. CTSI et al., for example, note that any averaged rate structure contemplates customers that generate more costs than revenues being offset by others that generate more revenues than costs; that if Bell Atlantic-New York's residential retail rate is inadequate, it should be examined elsewhere; that dial-up access to the Internet generates other sources of revenues for an ILEC, such as additional lines and vertical features; and that the existence of Bell Atlantic-New York's own ISP (Bell Atlantic.net) suggests that its end-user rate structure supports dial-up access to ISPs, for if it did not,

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[65] AT&T's Initial Brief, p. 7.

[66] TRA's Initial Brief, pp. 4-5.

its provision of a competitive ISP service would be unlawfully subsidized by its monopoly ratepayers.[67] Lightpath argues that any mismatch between revenues from calls with long holding times and the costs of carrying those calls should not be solved through adjustments to reciprocal compensation; to do so, it says, would force CLECs to subsidize calls with long holding times originated by ILECs.

Finally, several CLECs, including Global NAPs, assert that even if it made more sense to recover ISP termination costs through carrier access charges (on the premise that ISPs are analogous to carriers rather than final destinations for traffic), doing so is precluded. The only way to recover those costs, accordingly, is through reciprocal compensation.

4. Legal and Procedural Points

Lightpath, among others, contends that the existing reciprocal compensation framework is legally binding for local (i.e., for purposes of this case, non-ISP) traffic, pointing to the doctrine of functional equivalence as determinative. Bell Atlantic-New York does not really dispute that point, though it takes a very different view of what "functional equivalence" entails. CTSI et al. cite the provision of the FCC's rules that prohibit an ILEC from charging a CLEC element rates that "vary on the basis of the class of customers served by the requesting carrier, or on the type of service that the requesting carrier purchasing such elements uses them to provide."[68] Bell Atlantic-New York responds that it is proposing to distinguish among types of traffic, not types of customer,[69] and that such distinctions are clearly permitted, as evidenced by the authorization to apply different rates to

[67] CTSI et al.'s Initial Brief, pp. 25-26.

[68] 47 C.F.R. §51.503(c).

[69] The exception is for ISP customers, no longer subject to the FCC's rule.

tandem-routed and end-office-routed traffic.

In addition, Lightpath, CTSI et al., and others assert that regardless of what may otherwise be decided in this case, existing interconnection agreements should prevail at least until the ends of their terms.

Bell Atlantic-New York responds that its proposals should be incorporated into existing agreements only to the extent those agreements, by their own terms, require or allow that incorporation. The proposals, in its view, should guide interconnection negotiations, be incorporated in LEC tariffs, and be applied in resolving disputes, but should not alter existing agreements.

On a more specific matter, Bell Atlantic-New York observed in its initial brief that "agreements already in force should be interpreted in accordance with normal principles of contract interpretation."[70] Citing its comments in the Chatline Proceeding, it went on to assert that those agreements, properly interpreted, would not provide for inter-carrier compensation for Internet traffic, presumably because such traffic does not "terminate" on the receiving carrier's network (consistent with the FCC's finding in its ISP Ruling). In its reply brief, Lightpath strongly disputes that reading, insisting its agreement with Bell Atlantic-New York was intended to include Internet traffic, and it asks us to clarify that Bell Atlantic-New York must continue to honor its contractual agreements until they expire.[71]

Positions of State Agencies

1. CPB

CPB attributes traffic imbalances to multiple factors: like the CLECs, it sees the imbalances as resulting from the ILECs' failure to open markets adequately and from

[70] Bell Atlantic-New York's Initial Brief, p. 5.

[71] This specific issue, along with others, is resolved below, in the "Discussion and Conclusions" section.

the CLECs' own logical business plans; but, like the ILECs, it also assigns a role to the incentives provided by the reciprocal compensation structure. It suggests that excessive reciprocal compensation rates artificially discourage competition for customers that originate telephone calls, such as residential and small business customers, and it therefore sees a need to adjust the existing system while still providing compensation for all call termination. (Its proposal is described in detail below.) To ensure, however, that the traffic imbalances that are dealt with by its proposal do not result from the ILECs' failure to open their markets to CLECs, it would defer application of its remedy until the ILECs' local market is fully open to competition.[72]

In response, Bell Atlantic-New York argues that if the market is not yet fully open (a premise it rejects) continuing to make niche markets artificially attractive will work against the development of local competition, not in favor of it. And even if its actions prevented CLECs from maturing to tandem functionality (another premise it rejects), that would be no reason to provide reciprocal compensation at above-cost levels. AT&T, citing CPB's statement that "one reason for the current imbalance in the exchange of traffic between ILECs and CLECs is that ILECs' local markets are not yet open to competition," asserts that "as recognized by the CPB, the real reason for the current imbalance in traffic flows is that [Bell Atlantic-New York] has not yet opened the local market to broad based competition."[73]

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[72] CPB's Initial Brief, p. 19.

[73] Id.; AT&T's Reply Brief, p. 8 (emphasis supplied in both quotations).

2. The Attorney General

As noted, the Attorney General emphasizes the need to avoid any steps that would impede widely available Internet access.

SPECIFIC PROPOSALS

Bell Atlantic-New York's Proposals

1. Exclusion of Vertical Feature Costs

Bell Atlantic-New York proposes to exclude from the Phase 1 switching costs on the basis of which reciprocal compensation rates are set all costs associated with "vertical features," such as call waiting, which are not used in the simple routing and delivery of traffic. Acknowledging that the amount to be excluded cannot be determined on the basis of the record in Phase 1 of the First Network Elements Proceeding, it suggests a reduction of 30%, subject to true-up following a closer examination of the issue in the Second Network Elements Proceeding. Characterizing the proposal as a "modest" one that "has been inexplicably controversial,"[74] it suggests that parties opposing it have misunderstood the purpose of the Phase 1 studies, which were concerned with switching costs in general and not their relationship to intercarrier compensation rates, in connection with which disaggregation of switching costs into "originating" and "terminating" components is warranted.

Several CLECs, including AT&T, Lightpath, and Global NAPs, suggest that the vertical features proposal, which applies to all traffic, not only to large-volume traffic to single customers, is beyond the scope of this case and may or should be examined elsewhere. Lightpath and CTSI et al. assert as well that Bell Atlantic-New York has offered no support for its proposal, either to show that vertical features are not used in call termination or to show that the 30% adjustment is a reasonable place holder pending further

[74] Bell-Atlantic-New York's Initial Brief, p. 17.

inquiry in the Second Network Elements Proceeding.

Some CLECs question the motivation for Bell Atlantic-New York's proposal. CTSI et al. suggest that Bell Atlantic-New York is contriving to remove these costs from reciprocal compensation (so it will pay less) while leaving them in network element rates (so it will receive more). Global NAPs suggests that Bell Atlantic-New York has become concerned that reciprocal compensation rates may be too high only in light of its realization that it will have to pay compensation, not merely receive it. It sees this as a benefit of the present system's imposition on Bell Atlantic-New York of competitive pressures to establish the lowest reasonable call termination rate.[75] Frontier, in its reply brief, accepts that challenge and urges reduction of the rate to zero, that is, its replacement by bill-and-keep.

2. Non-ISP Convergent Traffic

Bell Atlantic-New York proposes to allow Meet Point B (tandem-rate) reciprocal compensation to be charged "only when traffic is being delivered or terminated (a) through a tandem point of interconnection, or (b) through facilities that are 'functionally equivalent' to a tandem. This rule should be applied symmetrically to all carriers, both CLECs and incumbents. It would call for different results, however, depending upon the type of network architecture used by the carrier in question."[76] More specifically, a CLEC would be paid tandem-rate reciprocal compensation if, like Bell Atlantic-New York itself, it installed one or more tandem switches, used them to provide an actual tandem functionality, and offered other carriers the option of interconnecting either at the tandem or at the end office. In addition, tandem rate compensation would be paid

[75] Global NAPs' Initial Brief, p. 2, n. 3.

[76] Bell Atlantic-New York's Initial Brief, p. 20 (emphasis in original, footnote omitted).

to a CLEC that did not use tandem switching but whose facilities were nevertheless functionally equivalent to a tandem switch. As the wording of its proposal suggests, Bell Atlantic-New York sees it as consistent with the doctrines of functional equivalence and symmetry, properly understood. In Bell Atlantic-New York's view, however, the functional equivalence test cannot be met for large volume one-way traffic.

The claim of functional equivalence for a tandemless network is based on the premise that long loops, SONET rings, and other facilities take the place of the tandem and provide similar functionality. But Bell Atlantic-New York maintains that such wide area functionality need not be used in delivering traffic to a small number of large volume customers (in contrast to a widely dispersed base including substantial numbers of small customers). In the former instance, the delivering carrier can use high capacity facilities having a lower per-minute cost than the voice grade facilities needed to deliver traffic to a widely dispersed group of customers. In addition, Bell Atlantic-New York cites Global NAPs' witness's statement that ISP-bound traffic makes more efficient use of switching and transport capacity than does conventional voice telephony.[77] Beyond these factors, Bell Atlantic-New York continues, delivery of traffic to a small number of large volume customers permits a carrier to avoid the costs associated with substantial numbers of idle distribution facilities.

To show that its proposal is consistent with the FCC's rule, Bell Atlantic-New York points to the rule's statement that a CLEC is entitled to tandem interconnection rates when its switch "serves a geographic area comparable to the area served by the incumbent ILEC's tandem switch"[78]; and

[77] Ibid., p. 24, citing Tr. 649. (Bell Atlantic-New York refers to the witness as Cablevision's rather than Global NAPs'.)

[78] 47 C.F.R. §51.711(a)(3) (emphasis supplied).

it maintains that "'serving' an area does not merely entail delivering traffic to a few customers located within that area, no matter how large it may be."[79] It may be significant in this regard that AT&T refers to the FCC's standard not as "functional equivalence," which it attributes only to our Framework Order, but as "geographic equivalence," perhaps intending in this way to counter Bell Atlantic-New York's multi-faceted view (comprising nature of service as well as geography) of functional equivalence.

Recognizing that start-up CLECs will use fewer switches and an extended loop distribution architecture as the functional equivalent of a mature ILEC network using tandems, Bell Atlantic-New York nevertheless contrasts a start-up CLEC intending to be a full service provider with one targeting large volume convergent customers. It asserts that the former will necessarily install more extensive and less efficiently used facilities and will eventually be required to install tandem switching as its network begins to resemble that of a mature ILEC; the niche player, in contrast, will not be required to make these investments. And even if the niche player changed its strategy and began to seek a general customer base, the portion of its network designed to serve convergent customers would remain more efficient.

Further reducing the cost of serving large-volume convergent customers, Bell Atlantic-New York argues, is the ability to use shorter connections between the CLEC switch and the customer, perhaps even reducing that distance to zero through collocation.

To translate the foregoing analysis into rates, Bell Atlantic-New York would use traffic ratios as a measure of functional equivalence: a high ratio would be taken to imply that the CLEC was serving a high proportion of convergent customers; a ratio close to one would suggest that the CLEC, like Bell Atlantic-New York, itself, was serving a

[79] Bell Atlantic-New York's Reply Brief, pp. 12-13.

representative distribution of customers. It proposes a ratio of 2:1 as the dividing line: Meet Point A (end-office) rates would apply where the ratio was 2:1 or greater; Meet Point B (tandem) rates would apply only where the ratio was less than 2:1. The proposal would apply to all types of convergent traffic, not merely that directed to the Internet. In Bell Atlantic-New York's view, reference to the traffic imbalance is reasonable because such an imbalance can arise only if one carrier is serving customers that receive more traffic than they originate; and it entails little administrative cost, since traffic flows in each direction are already billed. It regards the 2:1 threshold as generous, since, in principle, it would be reasonable to charge the lower rate for all traffic in excess of a 1:1 ratio.[80]

Finally, Bell Atlantic-New York denies that its proposal unfairly penalizes CLECs; it applies, it says, not to particular carriers but to particular traffic. A CLEC serving that type of traffic would receive the end-office rate; a CLEC serving a broader and more dispersed group of customers might receive the tandem rate. Bell Atlantic-New York characterizes its proposal not as a penalty imposed on CLECs that focus their efforts on ISP customers, but as a means of insuring that they are not rewarded by being over compensated for their efforts.

As already suggested, CLECs take the position that Bell Atlantic-New York's understanding of functional equivalence violates the FCC's rule. CTSI et al., for example, dispute the premise that a CLEC could receive the tandem rate only if it served thousands of customers within the pertinent geographic area. They assert that "if a CLEC has facilities in place that provide tandem switch functionality capable of serving many customers in a geographic area comparable to that served by [Bell Atlantic-New York's] tandem switch, that is sufficient. Nothing more

[80] Bell Atlantic-New York's Reply Brief, p. 17.

is required under the FCC's test."[81] In addition, they complain Bell Atlantic-New York is proposing to charge CLECs different rates on the basis of the types of customers they serve, contrary to the FCC's rules.[82] Lightpath maintains the efficiencies CLECs allegedly enjoy on account of serving a small number of large customers have no application to full service providers, whose networks are built to serve a wide customer base, even if they serve ISPs as well.[83] Global NAPs, meanwhile, maintains that the number of customers served by the CLEC has no bearing on whether it meets the functional equivalence standard. Beyond that, it contends a CLEC can "serve" a wide geographic area by allowing its customers to collocate with it, even without constructing a fiber network traversing the area: "a CLEC may 'serve' a wide geographic area. . . by incurring the costs associated with allowing its customers that need to receive calls from such an area to collocate at [its] switch, by incurring the costs associated with deploying physical facilities to customer locations in different local calling areas throughout the LATA, or some combination of both."[84] It warns against penalizing the smallest and newest CLECs or motivating them to sign up a handful of customers in diverse locations merely to qualify for the tandem rate.

CLECs also challenge Bell Atlantic-New York's use of a 2:1 ratio as the demarcation point between the two rates, claiming it has shown no link between that traffic ratio and a CLECs termination costs. CTSI et al. cite a Maryland proceeding in which Bell Atlantic-Maryland's counsel acknowledged the ratio was "arbitrary."[85] Lightpath similarly

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[81] CTSI et al.'s Reply Brief, p. 9.

[82] 47 C.F.R. §51.503(c).

[83] Lightpath's Reply Brief, pp. 4-5.

[84] Global NAPs' Reply Brief, p. 14.

[85] CTSI et al.'s Reply Brief, p, 7, citing Complaint of MFS

sees no factual support for the 2:1 ratio, disputing what it characterizes as Bell Atlantic-New York's view that "the interests of full-service, facilities-based CLECs are accommodated by its ratio approach."[86] It reiterates the claim that its switches serve an area at least as large as that served by a typical Bell Atlantic-New York tandem and that Bell Atlantic-New York can reach all its customers through a single point of interconnection; it therefore sees itself as meeting our test of tandem functionality as well as the FCC's, regardless of its traffic ratio.

Finally, MCIW pursues a somewhat different line of reasoning, arguing that Bell Atlantic-New York's proposal would, in effect, improperly force CLECs to install tandem switches and build inefficient networks simply to satisfy Bell Atlantic-New York's requirements.

3. ISP Traffic

Given the flexibility afforded the states by the FCC's determination that Internet traffic is exempt from reciprocal compensation, Bell Atlantic-New York argues that we would be justified in setting compensation for that traffic at zero. It cites in this regard the Massachusetts decision, noted above, that declined to mandate payment of reciprocal compensation for Internet traffic and left it to the parties to negotiate their own arrangements; it asserts that the New Jersey Commission recently reached a similar conclusion. Should we decline to take so drastic a step, Bell Atlantic-New York would recommend a rate equal to what it terms "direct variable costs."

In support of its zero-compensation proposal, Bell Atlantic-New York contends that, in principle, ISPs are interstate carriers who should pay carrier access charges.

Intelenet of Maryland Against Bell Atlantic of Maryland, Case No. 8731, Hearing Proceedings (April 14, 1999) Tr. 167-168.

[86] Lightpath's Reply Brief, p. 6.

Because the FCC has exempted them from access charges, however, both the originating and terminating LECs are undercompensated. Asserting, with illustrations, that Bell Atlantic-New York's revenues from its customers who place calls to ISPs tend to be below cost, it argues that requiring it to pay intercarrier compensation to the terminating carrier makes a bad situation worse and requires "ILECs [to] remit to CLECs revenues that they never receive";[87] it would be better in its view "for the Commission to restrict both LECs to the local exchange revenues each receives from its customer (in the case of the originating LEC, the local charges the Internet user pays; in the case of the LEC delivering the call to the ISP, the local charge the ISP pays). This proposal is competitively neutral as between the two involved LECs."[88] Bell Atlantic-New York regards a zero rate as further justified by the abusive tactics of those CLECs using ISP traffic to generate reciprocal compensation revenue streams, as discussed earlier. Noting the claim that CLECs' termination of calls enables ILECs to avoid the cost of termination, Bell Atlantic-New York contends that intercarrier compensation is not based on avoided costs; it is designed to compensate the terminating carrier for the costs it incurs.

Bell Atlantic-New York's alternative proposal for ISP traffic would take the current Meet Point A and Meet Point B rate levels (reduced to eliminate vertical feature costs in accordance with its first proposal) and adjust them to remove investment costs (depreciation and return) and joint and common costs, all of which are included in the TELRIC analysis that forms the basis for the existing rates. (It denies such rates would be confiscatory, inasmuch as the CLEC could recover its costs from its ISP customer.) The precise rate levels would be determined in the Second Network Elements

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[87] Bell Atlantic-New York's Reply Brief, p. 20.

[88] Bell Atlantic-New York's Initial Brief, p. 36 (emphasis in original).

Proceeding, but Bell Atlantic-New York suggests interim rates based on the record of the First Network Elements Proceeding. Noting that CLECs have argued that reduced compensation rates for Internet traffic would deter Internet growth, Bell Atlantic-New York asserts that ISPs already benefit from their exemption from interstate access charges, and it cites the Massachusetts Commission's observations that the Internet is powerful enough to stand on its own and that eliminating the subsidies produced by regulatory distortion would encourage efficient investment in Internet and other technology.

Administering these proposals would require a means to identify Internet traffic, and Bell Atlantic-New York, consistent with its view of burden of proof in this case, would impose the burden of identifying the traffic on the CLEC. In the absence of a showing by the CLEC, Bell Atlantic-New York would presume all convergent traffic (i.e., all traffic in excess of its proposed 2:1 ratio discussed in the previous section) to be Internet traffic.

CLECs press various arguments in response. e.spire/Intermedia dispute the premise that states are free to set below-TELRIC rates for ISP traffic, contending that the FCC ISP Ruling granted them, until a final federal rule is promulgated, only "the authority under section 252 of the [1996] Act to determine intercarrier compensation rates for ISP-bound traffic."[89] In its view, the reference to §252 requires TELRIC-based rates for ISP traffic. CTSI et al. and Global NAPs dispute Bell Atlantic-New York's reference to the Massachusetts ISP decision, the former noting that the portions it relies on are disputed dicta and the latter citing the many states that, in contrast to Massachusetts (and, more recently New Jersey), have held ISPs to be no different from other calls with regard to reciprocal compensation. CTSI et al. also note the FCC's statement in its ISP ruling that CLECs

[89] e.spire/Intermedia's Initial Brief, p. 11, citing the FCC ISP Ruling, ¶25 (emphasis supplied).

incur costs to deliver ISP traffic and that some compensation is warranted to enable them to recover those costs.[90]

Global NAPs disputes the relevance of Bell Atlantic-New York's allegations that it fails to recover its costs of originating ISP-bound calls, arguing that they are no different in this regard from all other local calls with longer-than-average holding times. In its view, the only pertinent question is whether local calling revenues overall suffice to recover the costs of local calling; it charges that Bell Atlantic-New York would have "CLECs . . . made into indentured servants for Bell Atlantic-New York's end-users who, after all, are the source of both the costs and the revenues at issue here."[91] (Bell Atlantic-New York maintains, however, that its local calling rates were set before the advent of the Internet and are now capped under its Performance Regulation Plan.) Global NAPs argues as well that if all CLECs that served ISP customers disappeared, Bell Atlantic-New York's costs would increase by more than it would save by avoiding reciprocal compensation payments, for it would have to augment its own network to complete the calls directed to ISPs. Bell Atlantic-New York's proposal therefore

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[90] FCC ISP Ruling, ¶29.

[91] Global NAPs' Reply Brief, p. 15. Global NAPs supports reciprocal compensation in part on the premise that local calling is "sent paid," that is, the originating carrier is to collect from the end-user revenues adequate to deliver the call to its destination. If a different carrier terminates that call, those revenues should be shared so the terminating carrier can recover its costs. (Global NAPs' Initial Brief, pp. 3-4.) BA takes the view that any such sharing, if applied pro rata (on the basis of each carrier's costs) to existing originating revenues would produce reciprocal compensation payments below current end-office rates. It therefore regards Global NAPs reasoning as suggesting a remedy that, while not a substitute for its own proposal, "at least would eliminate the absurd and anti-competitive requirement that originating ILECs remit to CLECs revenues that they never receive and that are below the originating ILECs' costs." (Bell Atlantic-New York's Reply Brief, p. 20.)

would grant Bell Atlantic-New York a windfall by permitting it to continue to avoid those costs while freeing it of any (or most) of its reciprocal compensation obligation.

Finally, the Attorney General asserts that by entering the market for ISP-bound traffic, CLECs have contributed to the greater availability of Internet access to end-users. He suggests that "changing or abandoning reciprocal compensation for ISP-bound traffic could have the detrimental effect of limiting consumer choice in securing internet access, and increasing the price of such service, which in turn might limit the number of New York consumers who can avail themselves of internet access. The Commission should avoid this result."[92]

[92] Attorney General's Reply Brief, p. 6.